

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:LM:CTM:SJ:TL-3097-00

LBBelote

date: JUL 09 2001:

to: Dennis C. Omer
Team Coordinator, LMSB

from: LMSB Division Counsel
Area 5 (CC:LM:CTM:SJ)

subject: [REDACTED]
TL-N-3097-01

DISCLOSURE STATEMENT

This memorandum may contain privileged information. Any unauthorized disclosure of this memorandum may have an adverse effect on privileges, such as the attorney-client privilege. If disclosure becomes necessary, please contact this office for our views.

DISCUSSION

As we previously told you, we forwarded a copy of our recent memorandum to you regarding [REDACTED] to the National Office for post-review. The National Office has informed our office that they agreed with our conclusion that the obligation in question, a line of credit issue under a Credit Agreement, did not constitute corporate acquisition indebtedness within the meaning of I.R.C. §279 if the form of the transaction is respected. However, it was noted that if the taxpayer is viewed as issuing the obligation as part of an "investment unit or other arrangement" that includes its convertible Series B preferred stock, then the obligation might be treated as convertible under Treas. Reg. §1.1279-3(d). Thus, it could fulfill one of the four conditions set forth in I.R.C. §279(b) required to be satisfied before an obligation is held to constitute corporate acquisition indebtedness. At this point in time, we have doubts as to whether the line of credit and preferred stock could be considered an investment unit. If you wish to pursue this issue, please let us know.

In any event, I am pleased to tell you that the National Office was very excited to see your team's development of the above-described issue. The attorney in National Office with whom we corresponded told us that he had not seen the issue in a long time and despite the fact that he concurred with our analysis, he was thrilled that Exam had spotted this issue. He specifically wanted us to let the team know what a great job the National Office felt they were doing.

If you have any questions or concerns, please do not hesitate to contact Lloyd Silberzweig at (408) 817-4667, or the undersigned attorney at (408) 817-4694.

M. KENDALL WILLIAMS
Associate Area Counsel (LMSB)

By: Laura B. Belote

LAURA B. BELOTE
Attorney (LMSB)

memorandum

CC:LM:CTM:SJ:TL-N-3097-01
J:\LTS\------.wpd



date: **MAY 14 2001**

to: Dennis C. Omer
Team Coordinator, LMSB

from: LMSB Division Counsel
Area 5 Counsel (CC:LM:CTM:SJ)

subject: [REDACTED]

TL-N-3097-01

This memorandum may contain privileged information. Any unauthorized disclosure of this memorandum may have an adverse effect on privileges, such as the attorney-client privilege. If disclosure becomes necessary, please contact this office for our views.

This memorandum responds to your request for assistance as to whether certain interest paid by [REDACTED] (the "Taxpayer"), is subject to deduction limitations pursuant to I.R.C. § 279 (i.e. the limitations on deductions for corporate acquisition indebtedness).

FACTS

Background

The Taxpayer is a communications company engaged in

[REDACTED]

. The Taxpayer [REDACTED] approximately [REDACTED], including the [REDACTED], the [REDACTED], and the [REDACTED].

In [REDACTED], [REDACTED]¹ consolidated [REDACTED] of its [REDACTED] and related operations, "[REDACTED]" in [REDACTED], Missouri, "[REDACTED]" in [REDACTED], Texas, "[REDACTED]" in [REDACTED], Illinois, and "[REDACTED]" in [REDACTED], Pennsylvania, into [REDACTED] (" [REDACTED] ") (a.k.a. [REDACTED]).

Debt

On [REDACTED], [REDACTED] and [REDACTED] (" [REDACTED] ") entered into a Credit Agreement allowing [REDACTED] to borrow up to \$ [REDACTED] from [REDACTED]. According to the [REDACTED]'s financial statements in the Taxpayer's Form 8-K,² [REDACTED] borrowed \$ [REDACTED] from [REDACTED] on [REDACTED]. Although the copy of the [REDACTED] Credit Agreement provided to our office did not contain the schedules or the exhibits referenced therein, the Credit Agreement appears to be a line of credit without an option for the creditor (i.e. [REDACTED]) to convert the debt into the debtor's stock (although [REDACTED] was the original debtor, the Taxpayer subsequently guaranteed the debt as discussed below).

Merger and Debt Assumption

During a special meeting of the Taxpayer's Board of Directors (the "Board") held on [REDACTED], the same day the Credit Agreement was entered into between [REDACTED] and [REDACTED], the Board authorized the acquisition of the four above-described [REDACTED] from [REDACTED] for up to \$ [REDACTED], payable in the Taxpayer's stock and the assumption of debt. On [REDACTED], the Board held another special meeting during which it was informed that the Taxpayer and [REDACTED] had reached an agreement for the purchase of the [REDACTED]. The Acquisition Agreement between the Taxpayer and [REDACTED], entered into on [REDACTED], provides that the Taxpayer would acquire [REDACTED] percent of [REDACTED]'s outstanding Class A common stock

¹ The Taxpayer's Form 8-K, filed with the Securities and Exchange Commission ("SEC") on [REDACTED], states that [REDACTED] indirectly owned all of the outstanding stock of [REDACTED] and that on [REDACTED], the [REDACTED] acquired all of the outstanding stock of [REDACTED].

² The Form 8-K was filed with the SEC on [REDACTED].

([REDACTED] shares) for \$ [REDACTED], consisting of \$ [REDACTED] of the Taxpayer's Series B preferred stock ([REDACTED] shares) and assumption of \$ [REDACTED] of debt.³ The Taxpayer's Series B preferred stock was convertible into [REDACTED] shares of its common stock.

On [REDACTED], the Taxpayer incorporated [REDACTED] as a wholly-owned subsidiary solely for the purpose of merging with and into [REDACTED]. Three days later, on [REDACTED], the Taxpayer completed the acquisition of [REDACTED] through the tax-free merger of [REDACTED] with [REDACTED]. The surviving corporation was named [REDACTED] and was a wholly-owned subsidiary of the Taxpayer.

Note D of the Notes to the Pro Forma Financial Statements, states, "[t]o record interest expense (\$ [REDACTED] for the quarter ended [REDACTED] and \$ [REDACTED] for the year ended [REDACTED]) on the bank debt to fund the acquisition."⁴ (Emphasis added).

ANALYSIS

Interest deductions of corporations are limited where the related debt is "corporate acquisition indebtedness." I.R.C. § 279(a). In general, corporate acquisition indebtedness is defined as any obligation evidenced by a bond, debenture, note, or certificate or other evidence of indebtedness issued by a corporation (after October 9, 1969) where such obligation is issued to provide consideration for the acquisition (either stock or assets) of another corporation. I.R.C. § 279(b)(1). In addition, I.R.C. §§ 279(b)(2), 279(b)(3), and 279(b)(4) limit corporate acquisition indebtedness to debt in which:

- (1) the obligation is either subordinated to the claims of trade creditors or subordinated in

³ Pursuant to a Guaranty dated [REDACTED], the Taxpayer unconditionally and irrevocably guaranteed the payment of the \$ [REDACTED] debt along with related interest. The balance of the debt to [REDACTED], approximately \$ [REDACTED], was retained by a [REDACTED] affiliate.

⁴ The Pro Forma Financial Statements were in the Taxpayer's Form 8-K filed with the SEC on [REDACTED].

- right of payment to the payment of any substantial amount of unsecured indebtedness of the debtor corporation;
- (2) the evidence of indebtedness is either:
 - (a) convertible into the stock of the debtor corporation; or
 - (b) part of an investment unit; and
 - (3) a certain debt to equity ratio is satisfied.

Due to the lack of certain information described below, we will make certain assumptions for purposes of this memorandum. Although we do not have detailed information regarding the Taxpayer's debt to equity ratio, based on discussions with you, we will assume that such ratio is satisfied. Similarly, we do not have the schedules to the [REDACTED] Credit Agreement or information regarding any other indebtedness of the Taxpayer. However, for purposes of this analysis we will assume that the obligation is either subordinated to the claims of the Taxpayer's trade creditors or that it is subordinated in right of payment to the payment of any substantial amount of unsecured indebtedness of the Taxpayer.

Finally, as stated above, the note must either be convertible into the Taxpayer's stock or part of an investment unit in order for the debt to be considered corporate acquisition indebtedness. § 279(b)(3). Based on our understanding of the transaction and our review of the Credit Agreement, the note was not part of an investment unit and the note does not appear to be convertible. Accordingly, the liability under the [REDACTED] Credit Agreement does not constitute corporate acquisition indebtedness.

Based on the above analysis, we do not believe the language of Note D of the Notes to the Pro Forma Financial Statements in the Taxpayer's Form 8-K filed [REDACTED] emphasized above is significant. If you obtain subsequent factual information indicating that the above conditions of I.R.C. §§ 279(b)(2), 279(b)(3), and 279(b)(4) are met, we would be glad to provide a supplemental analysis discussing the significance of note to the financial statements.

CONCLUSION

As set forth above, we believe that the liability is not corporate acquisition indebtedness and that the Taxpayer's interest deductions are not limited by I.R.C. § 279. As discussed above, our analysis assumes certain facts based on our discussions with you. Please contact our office if you subsequently determine that any of the factual statements herein are incorrect or if you obtain any additional information which you believe to be relevant. If additional facts establish that the debt may be corporate acquisition indebtedness, we will provide you with a supplemental memorandum addressing the fact that the Taxpayer is not the original corporation that entered into the Credit Agreement. Note that we have forwarded a copy of this memorandum to our National Office to ensure that the above analysis is consistent with the National Office position. We will notify you within approximately two weeks if the National Office believes that our analysis should be revised. If you have any questions on this matter, please contact the undersigned at (408) 817-4667.

M. KENDALL WILLIAMS
Associate Area Counsel (LMSB)

By: Lloyd T. Silberzweig
LLOYD T. SILBERZWEIG
Attorney (LMSB)

cc: Office of Chief Counsel
Technical Services Section
Room 4510
(w/copy of Credit Agreement enclosed)